Which Theory Is Directing China’s Reform of State-Owned Enterprises: From 1978 to 2008 and Onward?

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Which Theory Is Directing China’s Reform of State-Owned Enterprises: From 1978 to 2008 and Onward?

Zheng Li, Shuanping Dai

Abstract: China’s reform of state-owned enterprises (SOEs) has achieved notably through 30 years of reforms while the performance of SOEs is still low. Basing on a summing-up of reforms of SOEs the paper gives an evaluation of economic theories affecting China’s reform of SOEs. Focuses in different periods of the reform are varied, as are the theories guiding decision-making. This paper, taking the three representative arguments of Wu Jinglian vs. Li Yining, Justin, Yifu, Lin vs. Zhang Weiying, and Lang Xianping vs. Gu Chujun within the 30 years as a clue, has put in a model theories that affect China’s reform of SOEs like market economy theory, modern property right theory, modern firm theory, and management of state assets. The paper holds that economic theories that are able to guide China’s reforms of SOEs should possess at least the two theoretical characteristics: They can build SOEs into subjects of socialist market competition macro-economically and they can explain and solve the multi-level principal-agent relations of SOEs micro-economically.

I. Introduction

China’s traditional state-owned enterprises (SOEs) system is connected with the highly concentrated planned economy system. Under this kind of system, the enterprise is just a workshop in the national economy managed as a large factory under the regulation of state instruction plan. The enterprise is essentially a subsidiary of the administration authorities, but not an independent commodity producer. The enterprise system, which distinguishes from the state administrative authority system and is economically independent, in fact does not exist. Nor does the independent enterprise property right which relates with market transactions. As a result of these malpractices, before the reform and opening-up policy, the SOEs management system is rigid, management mechanism stagnant, the enthusiasm, initiative, and creativity of both the enterprise and the people seriously oppressed. For this reason reform of the SOEs takes mobilizing the enterprise and the people to enthusiasm for production and management as the starting point, and moves gradually in depth since the CPC’s 3rd session of the 11th central committee. In 1984, "the Central Committee of the CPC’s Resolution on Economic System Reforms" explicitly pointed out that, "the socialism of Chinese characteristics should first have enterprises gain full vigor. While various problems with the present economic system focus exactly on the fact that the enterprise lacks the vigor it should have.” Since then China's economic reforms have always centered on reforms of SOEs. It can be concluded that as the key link to China’s economy reforms, the reform and development of SOEs is the most important
factor affecting the formation and development of China’s socialist market economy, as well as the vigor and efficiency of national economy development. And more specifically, the reform of SOEs affects the economy structure adjustment, such as ownership structure, industrial structure, trade structure and so on. That is because the industrial distribution of SOEs is abnormal; the SOEs almost take part in all sectors of national economy before the reform.

Since the CPC’s 3rd session of the 11th central committee China’s gradual type of reforms have advanced from "testing each step before taking it" and have, during the 30 years, formed a reform and development path of Chinese characteristics, with the richness, the originality and the profound historical significance increasingly attracting people’s attention. "China’s pattern", "China’s experience", "China’s path" is vividly portrayed. As SOEs reform is the core and central constituent of China’s gradual type reforms, it is indispensable to the success or failure of the gradual reform. This paper attempts to help people understand the logic of China’s gradual type reforms from an angle of SOEs reform. It first reviews and summarizes the four stages of China’s SOEs reforms of the 30 years and its achievements; then it comments on three influential theoretical arguments in the history of China’s SOEs reforms, and summarizes and explains the inter-relations between SOEs reforms and the socialist market progression reflected by the arguments. As to the core content of the 30 years reforms of SOEs, it mainly centers on the management of maintaining and increasing state asset value and the entrustment to manage, as well as responsibility, authority and benefit related to management and entrustment. So viewed in depth the problem of SOEs reform is a two-way, multi-level principal-agent problem and the paper gives a particular research in the fourth part. As the conclusion, the fifth part summarizes and forecasts main research conclusions of the paper and main theory difficulties affecting China’s SOEs reforms.

II. The 4 stages and their effects of China's SOEs reform

Regarding the stage of China’s SOEs reforms, there are different ways to divide. Some scholars proposed two-stage theory (Liu, Zhongli, 2000), namely to divide the SOEs from the shallower to the deeper into stage of authority quit and benefit concession and stage of institution innovation. Some scholars proposed three-stage theory (Wang, Haibo, 2005; Liu, Hanmin, 2007), like expansion of autonomous right (1979-1984), separation of ownership and management (1985-1992) and establishment of modern enterprise institution (since 1993). Many other scholars propose four stage theory, but different in specific names and time spans. This paper, basing on the progression of China’s SOEs reform from the shallower to the deeper, divides into four stages of "authority quit and profit concession" (1978-1985), "transformation of management mechanism" (1986-1992), "innovation of enterprise system" (1993-1996) and "adjustment of economic structure" (since 1997).
1. Stage of authority quit and profit concession: expanding enterprise’s autonomous rights of operations and increasing profit portion of SOEs.

In view of the problem that the government controlled the enterprise so excessively under planned economy system and caused the enterprise to lack the vigor, the SOEs reform started first from quitting authority and conceding benefit. In December 1978, the 3rd session of the 11th central committee of CPC pointed out that, "(authority) should be released under leadership boldly to let local and industrial and agricultural enterprises have more autonomous right to management under unified state plan instruction", to change "the concentration of authority" phenomenon. In May 1979, the central government decided to have 8 SOEs, Capital Steel Corporation, Shanghai Diesel Engine Works and others as pilots of the country. In July of the same year, the State Council issued "Regulations on the Expansion of the Autonomous Right to Management of State-Owned Industrial Enterprises", "Regulations on Profit Retain of SOEs" and other documents. Hereafter release of authority and profit concession reforms started very quickly nationwide. In September 1981, the state started economic responsibility system against SOEs and established enterprise internal economic responsibility system to clarify the relations between authority, responsibility and right of the state, the enterprise, and the workers, and through combining them together made the enterprise gradually become the relatively independent economic entity. In April 1983, the state started to carry out the reform of tax-levying instead of profit-sharing for SOEs, namely the SOEs should pay taxes instead of turning in profits as it originally did, thus intensifying the enterprise’s budget constraint and increasing its motivation. In May 1984, the State Council issued "Temporary Regulations on the Further Expansion of State-Owned Industrial Enterprise’s Autonomous Right to Management", stipulating 10 autonomous rights to production management, product sales, pricing and other aspects. In September 1985, the State Council approved in extension "Temporary Regulations on Strengthening the Vitality of Large- and Medium-Sized State-Owned Industrial Enterprises" drafted by the State Economic Commission and the State Commission for Restructuring Economy, which has made 14 stipulations to continued to expand the enterprise’s autonomous rights.

The reform of "authority quit and profit concession" with the characteristic of interests re-adjustment has stridden across the traditional enterprise management system historically and has motivated both the enterprise and its workers in certain degree. But the old relational pattern between the state and the enterprise remained unchanged, and the enterprise was still in a status of subsidiary to the government administrative sections. In addition, the central government failed to implement effectively the authorities given to the enterprise, plus the soft budget restraint of the enterprise. The manager lacked enough accumulative motivation and thus it was very difficult for the reform to continue.

2. Stage of transformation of enterprise management mechanism basing on the theory of separation of ownership and management
In October 1984 the CPC’s 3 session of the 12th central committee established the goal for SOEs reforms as: The enterprise should actually become a relatively independent economic entity, a socialist commodity producer and operator who can make its own management decisions and take full responsibility for its own profits and losses, should have the ability of self-remolding and self-development, and should become the legal person having certain rights and responsibilities. Focusing on this reform goal, in April 1987, the central government decided to carry out contract institution nationwide and till year end 1988, nationally 95% of large- and medium-sized SOEs had implemented the first round of contracting, and by year end 1991, the enterprise whose contract expired in the first round transformed to the second round. The contract management responsibility system attempts, on the basis of persistence to public ownership, to separate property rights from managerial rights so as to separate government functions from enterprise management and thus distinguishing rights and liabilities. The contract system did play the role of mobilizing the enterprise to complete the profit goal in certain period, but the effect was extremely limited. The contract institution caused most enterprise managers to pursue for the maximization of short-term income in the contracted period but to neglect the enterprise’s long-term development, and many enterprises appeared "to be contracted when at profit but not at loss", and "contacted but not to bankrupt".

3. Stage of innovation of enterprise institution centering on establishing modern enterprise institution

In October 1992, the CPC’s 14th National Congress explicitly proposed that the goal of China’s economic restructuring was to establish socialist market economy system. In November 1993, the 3rd session of the 14th CPC central committee passed "Decisions of the CPC Central Committee on Problems Concerning the Establishment of Socialist Market Economy System", proposing that the goal of SOEs reform was to establish modern enterprise institution, and summarizing the modern enterprise institution characteristics into "clearly established ownership, well defined power and responsibility, separation of enterprise from administration, and scientific management". In December of the same year, the National People's Congress passed "Corporation Law of People's Republic of China". At the beginning of 1994 the State Council requested to carry out pilot project on the establishment of modern enterprise institution according to "Corporation Law", in order to disseminate in full scale after obtaining the experience. Since 1995 pilot projects authorized by the State Council started to work all around. Also in this year, the policy "to focus on the restructuring of major enterprises and relax control over minor ones", namely "to invigorate large while leave small" was proposed and started to implement. Basing on the plot projects, the work to establish modern enterprise institution was launched nationwide. Ever since establishing modern enterprise institution has gradually become the basic direction of China’s SOEs reform. The core of establishing modern enterprise institution is to reform the property right system of sate-owned enterprises and build clearly defined and reasonable enterprise property right relations. Its main contents are: consummate enterprise legal person system, strict limited liability system, and
sound corporation governance.

The difficulty and the key link for SOEs to establish modern enterprise institution is to build effective corporation governance. And it continues to be so until now. In 1999, CPC’s 4th session of 15th central committee adopted "Decisions of the CPC Central Committee on Reform and Development of SOEs Concerning Certain Major Issues", which for the first time proposed in official documents "corporation governance" concept, and which proposed "to clearly define the responsibility of the shareholder meeting, the board of directors, the board of supervisors and managers, so as to form corporate legal person governing structure with each party responsible for its duty, under coordinated operations and effective check and balance". In 2002 the CPC’s 16th national congress reports again explicitly proposed that "state-owned large- and medium-sized enterprises continue to implement the standardized corporate system reform to perfect legal person governing structure". In 2003 the state-owned assets supervision and administration institution was established to effectively fulfill the investor’s responsibility, and to deepen the state assets management system reform.

Generally speaking, until 1996 China’s SOEs reform didn’t obtain the results it should have. The amount of loss of SOEs increased, and portion grew (to see Table 1), even with net loss as the amount of loss for unprofitable enterprises surpassed the earning of profitable enterprises, and the number of industries entirely at loss also was increasing. In addition to that, there were more and more workers from SOEs to be laid off or unemployed, with income reduced and life in difficulty. The condition of SOEs has got attention and worry from both the government and the public.

Table 1 Increase of Loss of SOEs (1978-1996)

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount of loss (billion RMB)</th>
<th>Portion of unprofitable enterprises (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>4.2</td>
<td>——</td>
</tr>
<tr>
<td>1979</td>
<td>3.6</td>
<td>——</td>
</tr>
<tr>
<td>1980</td>
<td>3.4</td>
<td>22.9</td>
</tr>
<tr>
<td>1981</td>
<td>4.6</td>
<td>20.8</td>
</tr>
<tr>
<td>1982</td>
<td>4.8</td>
<td>12.8</td>
</tr>
<tr>
<td>1983</td>
<td>3.2</td>
<td>10.2</td>
</tr>
<tr>
<td>1984</td>
<td>2.7</td>
<td>10.2</td>
</tr>
<tr>
<td>1985</td>
<td>3.2</td>
<td>9.6</td>
</tr>
<tr>
<td>1986</td>
<td>5.4</td>
<td>13.1</td>
</tr>
<tr>
<td>1987</td>
<td>6.1</td>
<td>13.0</td>
</tr>
<tr>
<td>1988</td>
<td>8.2</td>
<td>10.9</td>
</tr>
<tr>
<td>1989</td>
<td>18.0</td>
<td>16.0</td>
</tr>
<tr>
<td>1990</td>
<td>34.9</td>
<td>27.6</td>
</tr>
<tr>
<td>1991</td>
<td>36.7</td>
<td>25.8</td>
</tr>
<tr>
<td>1992</td>
<td>36.9</td>
<td>23.4</td>
</tr>
</tbody>
</table>
After CPC’s 15th national congress the thinking for SOEs reform had new development, and the indicator is to readjust the strategic layout of state-owned sector of the economy according to its status and choose the way to reform SOEs. As early as September 1995 the CPC’s 5th session of 14th central committee explicitly proposed in "Long Term Program for 9th Five-Year Plan and 2010" that SOEs should be strategically restructured so as to invigorate the entire state economy. The CPC’s 15th national congress reports further expounded this guiding ideology, pointing out that "the SOEs reform should be connected with reorganization, transformation, and management enforcement; it must focus on the entire state economy to implement the strategic reorganization of SOEs; large enterprises should be revitalized while small ones be set free". The 4th session of CPC’s 15th central committee pointed out more explicitly in "Decisions on Reform and Development of SOEs Concerning Certain Major Issues" that "the strategic adjustment of the layout of state economy should be connected with optimizing and upgrading industrial structure and with adjusting and consummating ownership structure." The CPC’s 16th national congress report further emphasized "continuing to adjust the layout and the structure of state economy and reforming state assets administration system are the significant duty to further economic system restructuring." CPC’s 17th national congress report proposed "furthering the corporate joint stock system reform of SOEs, perfecting modern enterprise institution, optimizing layout and structure of state economy, and enhancing the vigor, control power, and influence of state economy". Obviously, adjustment of state economy structure and establishment of modern enterprise institution have become the basic direction for SOEs reform.

Since the CPC’s 15th national congress proposed strategically adjusting the layout of state economy in 1997, there has been substantive progress after 10 years’ efforts. State-owned economy and state-owned assets have gradually concentrated in important industries and key fields of national economy lifelines, and in big enterprises, gradually withdrawing from common competitive industries. The condition of large amount of SOEs dispersing in many fields started to change. As shown in Table 2, in 1998 there were 238,000 state-owned industrial and commercial enterprises; but in 2006 the number was reduced by half to 119,000. In 1997 the profits of state-owned industrial and commercial enterprises were 80 billion RMB Yuan; but in 2006 the profits reached 1200 billion RMB Yuan, 14 times’ growth. In 2000 the net assets of state-owned industrial and commercial enterprises reached 5755.44 billion RMB Yuan, with central enterprises’ net assets 3069 billion RMB Yuan. In 2006 net assets of central enterprises grew to 5390 billion RMB Yuan, with

<table>
<thead>
<tr>
<th>Year</th>
<th>1993</th>
<th>1994</th>
<th>1995</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits of SOEs (in billion RMB Yuan)</td>
<td>45.2</td>
<td>48.3</td>
<td>54.1</td>
<td>69.0</td>
</tr>
</tbody>
</table>

4. Stage of system innovation focusing on state economy restructuring
profits 768.15 billion RMB Yuan, and tax delivery 682.25 billion RMB Yuan. Also in 2006 the number of central enterprises whose sales income had surpassed 100 billion RMB Yuan was 21, and profits surpassing 10 billion RMB Yuan was 13.

Table 2 Economic Indicators of Reform and Development of China’s State-Owned Industrial and Commercial Enterprises 1998--2006

<table>
<thead>
<tr>
<th>Year indicators</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of SOEs (10,000)</td>
<td>23.8</td>
<td>21.7</td>
<td>19.1</td>
<td>17.4</td>
<td>15.9</td>
<td>14.6</td>
<td>13.6</td>
<td>12.6</td>
<td>11.9</td>
</tr>
<tr>
<td>Total assets (0.1 billion RMB)</td>
<td>134780</td>
<td>145288</td>
<td>160068</td>
<td>179245</td>
<td>180219</td>
<td>199971</td>
<td>215602</td>
<td>242560</td>
<td>290000</td>
</tr>
<tr>
<td>Net assets (0.1 billion RMB)</td>
<td>50371</td>
<td>53813</td>
<td>57976</td>
<td>61436</td>
<td>66543</td>
<td>70991</td>
<td>76763</td>
<td>87387</td>
<td></td>
</tr>
<tr>
<td>Sales income (0.1 billion RMB)</td>
<td>64685</td>
<td>69137</td>
<td>75082</td>
<td>76356</td>
<td>85326</td>
<td>100161</td>
<td>120722</td>
<td>140727</td>
<td>162000</td>
</tr>
<tr>
<td>Total profits (0.1 billion RMB)</td>
<td>800 (1997)</td>
<td></td>
<td>4852</td>
<td>7364</td>
<td>9190</td>
<td>12000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales profit ratio (%)</td>
<td>0.3</td>
<td>1.7</td>
<td>3.8</td>
<td>3.7</td>
<td>4.4</td>
<td>4.5</td>
<td>6.1</td>
<td>6.5</td>
<td>7.4</td>
</tr>
<tr>
<td>Tax delivery (0.1 billion RMB)</td>
<td></td>
<td></td>
<td>8140</td>
<td>10075</td>
<td>14000</td>
<td></td>
<td></td>
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<tr>
<td>No. of workers (10,000)</td>
<td>6394</td>
<td>5998</td>
<td>5564</td>
<td>5017</td>
<td>4446</td>
<td>3067</td>
<td>3660</td>
<td>3209</td>
<td></td>
</tr>
<tr>
<td>No. of central firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>157</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total assets of central firms (0.1 billion RMB)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>83280</td>
<td>122000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets of central firms (0.1 billion RMB)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>36000</td>
<td>53900</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total profits of central firms (0.1 billion RMB)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3006</td>
<td>7681.5</td>
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</tr>
<tr>
<td>Tax delivery of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3563</td>
<td>6822.5</td>
<td></td>
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</tr>
</tbody>
</table>
The above four stages of SOEs reform reflects the gradual, shallow-to-deep progression of China’s SOEs reforms and its path dependence. The SOEs reforms started from rebuilding and adjusting internal interest relations basing on combining two powers, then moved to transform the enterprise operating mechanism on the basis of separation of two powers, then innovated enterprise system on the foundation of re-defining property right, and finally restructured ownership basing on repositioning the function of state-owned economy and SOEs. Expanding enterprise autonomous right in 1978 as a "minor historical event" has bound the SOEs in the track of property right reform and market progression. Due to the fetter of the old economic system, limitation of people's cognitive capacity and the restriction of the original political legal system, the reform strategy of history seems at most second best today. However in the end it can lead SOEs stably to the proper way and this is irreversible.

III Three debates in Chinese SOEs reform history and their academic meanings

Chinese SOEs reform lasts for 30 years filled with so many debates. In this period, many economic characters and theories have emerged, such as “the marketization theory” raised by Wu Jinglian who is called “market Wu”, “the stock theory” raised by Li Yining who is called “stock Li”. “The property right theory” raised by Zhang Weiying, “the fair competition environment theory” raised by Justin, Yifu, Lin and so on. The theories led and promoted the above reform practically, at the same time, examined by the above reform. In the process of the interaction between theories and in the practices, there are three famous academic arguments outstandingly reflect the mainstream theories’ thinking in the Chinese SOEs reform, thus worth paying much attention.

 Debates between “Market Wu” and “Stock Li”

In the beginning, the argument about how to impel the reform mainly divided into two parts, took Wu Jinglian and Li Yining as representative respectively, it was called “Debates between Wu and Li”. Wu Jinglian thought that the reason why SOEs practiced low efficiency lies in the insufficient growth of the market and lacks of the necessary market price mechanism. In order to reverse this negative situation, price reform should be carried on firstly. Li Yining and some other economists raised the opinion that the reason why showed a low efficiency was that SOEs hadn’t been taken as an independent individual in the market. Only if the enterprises pursue the profit maximization and the SOEs become an independent enterprise genuinely, the SOEs could achieve overall efficiency enhancement.
Zhou Shulian, Wu Jinglian, Wang Haibo (1981) thought the way to improve the system of the whole people's ownership was to carry on the system reform. System reform should both maintain the state ownership and make the enterprise become the relatively independent management body. The current reform must be carried on according to the adjustment and improve the adjustment. In the current situation, the ownership could not be reformed radically, so we must pay attention to fully display the potential of the state-owned economy. Wu Jinglian (1992) pointed out once again that only the market relations—price fluctuation and the benefit changed by it could guide the enterprise to make decisions that ensured the social resource effective use. Li Yining (1986) thought that the SOEs reform was the key to establish the market economy in China. China must put reform on the traditional system of the whole people’s ownership and the traditional collective ownership; adjust the ownership which did not suit the socialism commodity economy development. In a part of the whole people owned enterprises (generally large and medium-sized Enterprises in their industries), we might make the stock system of ownership substitute for the traditional whole people ownership, and then formed the joint pattern ownership composed by the country, the enterprise and the workers. This procedure could not change the nature of the ownership in the socialist system, but it aimed at the establishment of new enterprises with the stock system of ownership.

“Debates between Wu and Li” is the confrontation of Chinese reform mentality. Actually they argued on the sequence of the two aspects of the same question, essentially the argument is the exploration of the way of Chinese economic reform. Chinese SOEs reform has enforced gradually in this kind of argument. Practically, the reform in the premise of following the market economy has enforced the stock system transformation in a suitable opportunity, thus has accelerated the establishment of Chinese market economy system. Justin, Yifu, Lin, Shen Minggao (1992) raised a viewpoint that may give the above argument a good summary, they believed that from the aspect of institution design, the joint stock system as if had possessed the function that stimulated the state-operated large and medium-sized enterprises, and it was a pattern of independent enterprise organization of commodity producer's. But if we took a look at joint stock system's external condition, the external environment and the system foundation of the reform was actually far from the Western joint stock system innovation and macroscopic system environment. Chinese market mechanism was imperfect, so the effect of the joint stock system reform would be difficulty to totally display. However, if we waited for all conditions to be satisfied, SOEs reform would be lagged seriously. That contradictory displayed the focal point of “Debates between Wu and Li”, simultaneously, also reflected what impede that kind of spanning type reform of China essentially.

“Debates between Lin and Zhang”

At the beginning of the SOEs reform, especially when the joint stock system reform took place, the problems we faced was still prominent. Justin, Yifu, Lin (1998, 1999, and 2003) believed that because of the lack of a perfect market system, transplanting
such a kind of “the modern enterprise system” was not the most crucial thing, the really important thing was to create a fair competition condition and environment, thus the budget would be restraint by it. Without a healthy competitive market environment, there wouldn’t be serials of targets that simply and intuitively reflected the enterprise management, therefore the owner would be unable to supervise the management of the enterprise, the problems between enterprise and operator's that different aims, asymmetry information as well as the unequal responsibility would be hard to handle with. Zhang Weiyi (1995b,1996) thought that the incomplete enterprise system was the main reason of the inefficiency of the SOEs, and that problem would be hardly solved under the system of the government-owned property, the only way out was to transfer “state-owned” enterprises to “non-state-owned” enterprises. It was impossible to raise and select the qualified entrepreneur community under system of the SOEs .The state-owned stockholder's rights must transform into creditor's rights or use other methods to realize the withdrawal of the state-owned stockholder's rights, making the state-owned business become the non-State-owned business.

Along with the SOEs reform's advancement, the conditions of this argument actually didn’t exist. The state-owned business withdrew from the general competition industry. A huge tide “the state withdraws and the private promote” has rolled up the past ten year of the SOEs reform, under such background, the third argument emerged.

“Debates between Lang and Gu”

The third argument was actually a debate between Lang Xianping and the Chinese mainstream economist. In August, 2004, Lang Xianping took Gu Chujun and other entrepreneur's management buy-out (MBO)as an analyst case, raised his opinions that a large quantity of the state asset had been out-flown and the staff benefit had been violated in the SOEs property right reform, he thought the reform was on a wrong direction. The main reason of some SOEs's inefficiency did not lay in the unclear property right either the owner vacancy or the unfair competition of the market; it lay in the lack of the trust responsibility of the SOEs operator and the lack of the professional manager market. Lang Xianping's opinion brought numerously opposition of Chinese economist immediately who supported MBO and the SOEs privatization. The focal points of both sides lie on processing the pattern of MBO or not, as well as other SOEs reform methods similar to the MBO form. The State-owned Assets Supervision and Administration Commission made a statement at the end of September in the same year that “the implementation of management purchases and controlling stock is not suitable with the goal of establishing the modern enterprise system and the direction of joint stock system reform”. It supported Lang Xianping's viewpoint to a certain extent, hereafter, when comes to the method of the SOEs reform, the decision-making strata and the academic circle starts to have reconsiderations.
Three debates have further reflected that Chinese SOEs reform was an evolutionary and continual process, following the socialist market economy system's consummation of China. At the same time, it also reflected constraints such as the SOEs reform's external environment, market competition main body and reform way, also their interaction. In fact, unintentionally, Chinese SOEs reform was processing precisely in the serials of “marketization (displays the function of market mechanism) — the market competition main body mold of the state-owned and the non-state-owned — creation fair competition environment —reasonable reform way (people may accept and withstand)”. These theories mostly weren’t correct-or-incorrect issues. Because of different historic condition and reform process, the emphasized point and the limitation was different from each other. But they were also not the supreme panaceas of SOEs reform, unable to solve the difficulty of the reform fundamentally all by itself. Especially in the relations between market environment and SOEs property right, the former is the latter’s external condition, and the latter provides the power for the former. In other words, unceasingly enhancing the marketability degree provides the fine market environment for the SOEs reform, the SOEs reform advancement also unceasingly strengthen the marketability level. Without a suitable market environment, its difficulty to achieve the goal of SOEs reform; similarly, many policies of the state enterprise reform raised the marketability level through changing the market microscopic structure. In fact, Chinese non-state-owned business’ excellent performance together with the state-owned business’ getting better and better shows that the market environment construction, the market competition main body mold and the state enterprise reform deepen interact with each other and win the result altogether.

IV Bilateral Principal-agent model and the effective explanation of Chinese SOEs

Although the reform of Chinese SOEs in different period is lead by different theory, from the view of overall evolitional process, the most effective explanation is multi-layer or bilateral Principal-agent model. In an another word, the process of the evolution of SOEs is a process of the chain of principal-agent being defined specifically; it is also the process of that the economic relationship between principal and agent is adjusted and competed. This happened in the beginning of reform, and it is still existed when the reform developed to the system innovation, whose core is to form the modern enterprise system and effective corporate governance structures. If it is not solved, we can not do anything effectively. So the degree of it is resolved is the real progress in the reform of SOEs.

The public nature of the SOEs doomed that the ultimate owners of corporate (principal) can not operate the asset directly. Companies only can be managed by specific government officials or their appointed agents. Therefore, it is a natural and appropriate analysis method that put SOEs the framework of principal-agent model. Research results from the domestic perspective, the principal-agent problem of SOEs
are focus on the most general of the agency relationship: government is the principal; the manager of SOEs is the agent.

If the manager of the firm (agent) can choose action set is $A$, special action $a \in A$. Agent’s and firm’s benefits are affected by white noise $\varepsilon$. $\varepsilon \sim N(0, \sigma^2)$. Agent action can bring benefit to the enterprise $R = f(a, \varepsilon)$, of course, the action will bring the cost $c = c(a)$ to the agent at the same time.

The revenue to the agent can be divided into two parts: fixed income $s$ and shared pay $d \cdot f(a, \varepsilon)$, $d$ is the share ratio (without tax factors). So the revenue function of agent is: $R_A = d \cdot f(a, \varepsilon) + s - c(a)$. Accordingly, the revenue function of principal is $R_p = (1 - d)R - s$.

According their revenue function, the total benefits $R_A + R_p$ is not equal to the real benefit $R$, the difference can be interpreted precisely by the cost of the agent action. So how to stimulate agent is a very important issue in the SOEs. In the traditional SOEs, which is lack of vitality and profit, is disregard of the agent's incentive problems. In order to change this situation, “authority quit and benefit concession”, “the reform of tax-levying instead of profit-sharing” or “contract institution”, implemented at the beginning of the SOEs reform, which all gave reward according to the operate performance to the manager (agent) gradually. But, it did not completely change the passive situation of the overall losses in SOEs. Principal-agent model have been successful partly in the reform, the thinking and policy implications described by this model provided an important ideas for China’s of SOEs reform.

Of course, principal-agent model is not only the simple meaning above. We assume that two parties are risk-neutral, to discuss how to design the arrangement to maximize two parties’ benefits. That is, in the situations $\max \{R_A + R_p\}$, how to set both goals and how to set up incentive programs.

Proposition 1: In the condition of risk-neutral, maximizing the revenue of the principal and the agent respectively, and to maximize the common interests of both are equivalent. (Prove elided).

Proposition 2: When the agent is risk averse, the level of incentives and degree of risk aversion is the inverse relationship: In order to encourage more efforts taken by the agent, the effect of the incentive strategy, adopted by the principal, depends on level of the agent's risk aversion. Agent risk aversion is the stronger; the incentive effects are not more notable. (Prove elided).

Proposition 3: If it is difficult to be observed when agent seeking private interests, the more incentive adopted by principal ,the more private interests be seek by agent, and the firm benefits unchanged or worsened.

Prove: assume that the total revenue for seeking private interests is $B$, the probability of be observed is $p$. Corresponding penalty is $F$. In this situation, the managers’ revenue functions is shown by this formula:

$$\max_{a}(−p)(d[f(a, \varepsilon) − B] + s + B) − pF − c(a)$$
After deduced, we can get \( (1 - p)df'(a, \varepsilon) = -(1 - p)(1 - d)B' + c'(a) \)

if \( p \to 0 \), then it will be \[ \frac{d}{d - 1} = \frac{B' + c'(a)}{f'(a, \varepsilon)} \]

so if \( d \uparrow \) and \( c'(a), f'(a, \varepsilon) \) is not changed. Then it will push \( B' \) up and to keep the equal balance.

In the three propositions, we can expose the reasons of the MBO trap, inner control and state-owned asset lost, which limited the SOEs reform and profit improve. Either the “authority quit and benefit concession” at the beginning of reform, or contract institution, both of them gave the independent right to the manager blindly, but lacked of enough supervision. For example, so far as it goes, MBO is a mature model of purchasing company, but owning to lacking of enough supervision. So lots of national property was emerged by alike Gu Chujun who purchased state owned enterprise. Principal-agent theory is a relatively mature theoretical system, it can explain the nature of the firm, the operation and management of enterprises very well, and further more, principal-agent theory is the basic framework of a lot of modern economic theory. Over the past 30 years of China's state owned enterprise reform process, this theory played a role in different level and different nature. It is inevitable that some economists are lack of understanding actual connotation and the establishment conditions of this theory perfectly, led to a lot of serious problems appeared, such as unilateral comprehension, deviate from the situation of china and decision-making misleading.

From an opener perspective, the principal-agent theory explained the fact that is not directed against the SOEs, agency theory can only explain part of problems existing in SOEs. As Justin, Yifu, Lin (1999) saying, the fundamental reason for SOEs ineffective supervision and restraint are not the public nature of the enterprise, but owning to lacking of performance evaluation standards on firm operation. In the late 1990s, especially in recent years, Chinese state owned enterprise reform began to reflect and they doubt the policy function of principal-agent theory. To strengthen the management of state-owned assets and improve the efficiency of corporate governance, reforms gradually extended. Principal-agent theory started phasing out study on China's state-owned reform. However, this is not the full negative to the principal-agent theory and principal-agent theory is a general theory. China's SOEs reform can further explore the deeper meaning of this theory. After all, the principal-agent relationship of china’s SOEs is far from being explained very perfectly.

Taking an overview of the research and practice of SOEs reform, the principal-agent relationship between the owner of the enterprise (Central Committee or the State-owned Assets Supervision and Administration Committee) and manager existed in SOEs was paid more attention generally. In fact, the principal-agent relationship of SOEs is not so simple like in the model analysis. For example, Zhang Weiyang (1995c) divided the relationship into two different kinds of class system. The first class system formed in the delegation chain of power between the principal (residual claim right) and agent (Central Committee), and its direction is from lower to higher. The second class formed in the delegation chain of power between Central
Committee and inner member of enterprise, and its direction is from higher to lower. As we can see, except for residual claim part and the member of the enterprise, the others are in bilateral principal-agent relationship. In fact, Zhang Weiying’s research was not practiced during the reform. Before 1978, if considered of its operating system, the SOEs cannot be called the "Enterprise" with truly enterprise attributes, but it is the implementation of the country's economic production plans and the government's economic policy. After the reform, though many reform measures have been trying to reform this situation, so that SOEs have become a true enterprise; up to now, many of the problems existed in SOEs are not resolved in essence. The contradictions and hidden crisis exist still in the remaining central enterprises and state-controlling enterprises, due to the principal-agent problem. How to hackle the multi principal-agent relationship in SOEs and to design mechanism are very important issues. First, the state, who is the representative of all the people, as the owner of the state-owned assets, this is a principal-agent relationship. The people, who is the ultimate owner of state-owned assets, how to supervise the state effectively, it’s not only a economic problem, but refer to the political institution. Whether the National People’s Congress as the institution to monitor the usage of the state-owned assets, to evaluate SOEs reform, and to ensure the value of state-owned assets preserve and increase, it is a need problem to be resolved in the future reform. Because judged from the historical evidence, the National People’s Congress can’t officiate the right very well. Secondly, the Central Committee appointed the general manager of SOEs; the researches on this kind of principal-agent relationship can not be considered simply from economic interests. Because of the special status of general manager, it is very difficult to define the private interests besides the basic incomes depend on the principal-agent model. Thirdly, how do the State-owned Assets Supervision and Administration Committee to manage SOEs correctly is also a problem of designing mechanism; How adjust the supervision and management of the State-owned Assets Supervision and Administration Committee still needs to research. Therefore, the special principal-agent relationship of SOEs still needs major breakthroughs in the future reform of SOEs. Principal-agent theory in the reform of China’s SOEs will remain a dominant position.

V Conclusion

Through the summary of theories which direct the SOEs reform from macroscopic and the microscopic aspects, The paper holds that economic theories that are able to guide China’s reforms of SOEs should possess at least the two theoretical characteristics: They can build SOEs into subjects of socialist market competition macro-economically and they can explain and solve the multi-level principal-agent relations of SOEs micro-economically. Generally speaking, Chinese 30-year SOEs reform is successful. But inevitably, some deep contradictions have not been thorough solved. The quantity of the Chinese State-owned business is already very small; there aren’t any conditions for the former reform pattern and methods to take place. The main reason of the difficulty on theory and in practice stems from SOEs' attribute. The
typical SOEs is a legally autonomous entity that operates along commercial lines but
is owned in whole or in part by a government (Garner 1970). The rapid spread of this
hybrid institution in many countries since World War II is documented, as ever
come a tendency of such firms to expand into international markets. The difficulty
of the state-owned business' research lies in the hardness to define the aim of
management of the SOEs (Cyert and March 1963, p. 26), and this is a global problem.

China's SOEs reform has its own characteristics which are different from other
capitalist countries’ SOEs reform. In China, the modern economic theory generally
needs to be unified with Chinese concrete national condition in order to play
effectively. At present, there are still many problems faced by the Chinese SOEs, such
as, how to display the special function of public nature of the SOEs, how to raise and
select entrepreneurs or professional managers who are suitable for the Chinese SOEs
management, how to guarantee the stableness and appreciation of the state asset, they
are not purely theoretical problems. However, in order to solve these problems,
Chinese and even economists all over the world should try to seek for a better theory
frame diligently.

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